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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

Nos. 76-1114, 76-1133, 76-1587

CALIFORNIA, ET AL.,

Petitioners,

v.

SOUTHLAND ROYALTY COMPANY, ET AL.,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF SOUTHLAND ROYALTY COMPANY, ET AL.

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BRIEF OF SOUTHLAND ROYALTY COMPANY, ET AL.

QUESTION PRESENTED

Whether the lessee under a fifty year fixed-term oil and gas lease may dedicate to interstate service under the Natural Gas Act gas in which it never had any ownership or other interest.

STATEMENT

This case involves the extent of the interstate service dedication created under the Natural Gas Act when a lessee made an interstate sale of the natural gas attributable to its fixed-term leasehold interest. The Federal Power Commission held that, when the lessee made inter-

state sales of the gas attributable to its fifty year fixed-term oil and gas lease, it thereby dedicated to interstate service not only all of its leasehold gas but also gas in which it never had any ownership or other interest — the gas belonging to the mineral fee owners, to be produced and marketed by them after expiration of the lease. On review, the court of appeals reversed, holding that the lessee "could not legally deal in or dedicate" the mineral fee owners' gas.

1. The Leases, Interstate Sales And Certificates.

In 1925, Gulf Oil Corporation (Gulf) obtained a fifty year fixed-term oil and gas lease[1] from the owners of the Waddell Ranch in West Texas. (A. 135-40). The lessors granted Gulf the right to the oil and gas Gulf found, developed and sold from the Waddell Ranch during a specified term of fifty years.[2] In 1926, the owners of the Waddell Ranch conveyed one-half of their mineral fee interest to Southland Royalty Company.[3] At about the same time,

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[1] Such fixed-term oil and gas leases are extremely rare. As early as 1928, it was recognized that fixed-term leases had "long been in disuse" and were "of no practical importance" in Texas. Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 7 TEXAS L. REV. 1, 15 (1928). *See also* 3 H. WILLIAMS, OIL & GAS LAW § 601 (1975); 1 E. BROWN, LAW OF OIL & GAS LEASES § 5.01 (2d ed. 1973). Virtually all modern oil and gas leases provide for the leasehold estate to remain in effect as long as either oil or gas is produced in paying quantities. 2 E. KUNTZ, LAW OF OIL & GAS § 26.1 at 244 (1964); 1A W. SUMMERS, LAW OF OIL & GAS § 153 at 381 (1959).

[2] Thus, Gulf's lease did not give it the right to produce and market "all" Waddell Ranch gas, but only to produce and market the gas it found, developed and sold during the specified fifty year term. *See Gulf Oil Corp.* v. *Southland Royalty Co.*, 496 S.W.2d 547 (Tex. 1973).

[3] *See* Vol. 13, pp. 585-87, Deed Records of Crane County, Texas. Thus, Southland Royalty Company acquired its 50% interest in the mineral fee estate 49 years before the expiration of Gulf's lease and long before interstate sales of gas had taken place. *See* note 6, *infra*. At about the same time, the Waddells conveyed the remaining 50% of the mineral fee to other respondents, such as Warren Wright, under whose will trustees own 25% of the mineral fee.

Gulf obtained an identical fifty year fixed-term lease on the Goldsmith Ranch, whose owners soon thereafter conveyed their mineral fee interest to Southland Royalty and other respondents.[4]

In 1951, Gulf commenced interstate sales to El Paso Natural Gas Company (El Paso) of casinghead gas[5] that Gulf was entitled to produce and market from a number of sources, including its fixed-term Waddell Ranch lease. (*See* A. 43).[6] Southland Royalty was not a party to Gulf's contract with El Paso, and could not have prevented its execution or performance. Southland Royalty's only economic interest in Gulf's sale of Gulf's leasehold gas was a fixed royalty of ⅛ of 4¢ per Mcf; Southland Royalty had no right to take a share of the leasehold gas in kind as royalty. (A. 135-40).

In 1954, following this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), Gulf applied for

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[4] Gulf did not own all of the leasehold interests. For convenience all lessees are referred to as "Gulf," the principal lessee; all mineral fee owners are referred to as "Southland Royalty," the principal mineral fee owner; and both of Gulf's sales are discussed in terms of the Waddell Ranch. This brief is submitted on behalf of the following mineral fee owners: Southland Royalty Company, the trustees under the will of Warren Wright, the Penn interests, Exxon Corp. and Texaco Inc.

[5] *I.e.*, gas in association with crude oil. Gulf's gas well gas from the Waddell Ranch was always sold in intrastate commerce, and therefore Southland Royalty's gas well gas is not at issue in this case. References in this brief to Waddell Ranch "gas" therefore mean casinghead gas.

[6] From 1927, when Gulf first discovered oil and gas, to 1951 all of Gulf's leasehold gas was sold or used entirely within the State of Texas. In fact, no gas produced in Texas from any source was sold in interstate commerce until 1948. *See* ANNUAL REPORTS OF THE RAILROAD COMMISSION OF TEXAS, GAS UTILITIES DIVISION. In 1950, the last full year before Gulf commenced its interstate sale to El Paso, less than one-third of all gas produced in Texas was sold interstate. *See* ANNUAL REPORT OF THE OIL AND GAS DIVISION, 1950, THE RAILROAD COMMISSION OF TEXAS at 11, 34-35. Thus, whatever the situation may have been in 1959, *cf. CATCO, Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 394 (1959), the interstate market was not the dominant market in 1951 when Gulf made its sale to El Paso.

and was granted a certificate of public convenience and necessity under Section 7(e) of the Natural Gas Act, authorizing the existing sale of its gas to El Paso. It is uncontested that in its certificate application, as in its contract, Gulf attempted no dedication of Waddell Ranch gas beyond the fixed-term leasehold interest it owned. (A.457).[7]

In 1975, Gulf's fifty year fixed-term lease expired according to its terms.[8] As owner of the mineral fee interest Southland Royalty thereupon came into present enjoyment of its estate. Gulf continued and still continues to sell substantial volumes of gas to El Paso under its contracts and related certificates because, although Gulf has no more Waddell Ranch leasehold gas, Gulf continues to have casinghead gas available from other sources. Southland Royalty contracted to sell its gas to Intratex Gas Company.[9]

2. **The Commission's Orders.**

Three days before Gulf's lease expired, the Commission held that, by making an interstate sale to El Paso, Gulf had dedicated to El Paso not only the gas that Gulf was entitled to produce and market under its fifty year fixed-term lease but also Southland Royalty's gas. On this basis the Commission prohibited Southland Royalty from selling its "gas

[7] In 1972, Gulf entered into a second contract to sell additional volumes of casinghead gas to El Paso, from a number of sources, including its Waddell Ranch lease. The Commission duly certificated Gulf's application to make this sale. It is also uncontested that in its 1972 contract and certificate application Gulf attempted no dedication of gas beyond the interests it owned. (A. 457).

[8] Before Gulf's lease expired, Gulf sued in an attempt to establish its right to continue to produce and market oil and gas from the Waddell Ranch. The Supreme Court of Texas rejected Gulf's attempt, holding unanimously that the lease provides "a plain and certain answer to the question of when the lease terminates." *Gulf Oil Corp.* v. *Southland Royalty Co.*, 496 S.W.2d 547, 552 (Tex. 1973).

[9] Intratex is an intrastate pipeline which primarily serves the distributor of gas to residential and commercial customers in the City of Houston, Texas, and also serves high priority industrial companies in the Houston area, *i.e.*, industrial users without alternate fuel capability.

in intrastate commerce without prior permission and approval of the Commission under Section 7(b) of the Natural Gas Act." (A. 611). The Commission also directed Gulf to seek "Commission permission and approval" to reduce its sales to El Paso. *Id.* The Commission's Staff characterized the legal issue as one of "first impression" (A. 367) and the Commission itself conceded that there was "no case directly in point." (A. 605).

On rehearing, the Commission reaffirmed its holding that Southland Royalty et al. "were subject to the dedication made by the leaseholders." (A. 709). The Commission admitted that it was "holding that the leaseholders, Gulf, et al., had power to encumber the property" of the mineral fee owners with the result that they "are forced to enter into an interstate sale against their will." (A. 712).

Gulf duly filed for partial abandonment.[10] Southland Royalty appealed to the Fifth Circuit.

3. **The Decision of the Court of Appeals.**

The court of appeals reversed, holding that "Gulf could not legally deal in or dedicate" Southland Royalty's gas to interstate service. *Southland Royalty Co.* v. *FPC*, 543 F.2d 1134, 1137 (5th Cir. 1976). The court therefore rejected the Commission's claim that Gulf had dedicated Southland Royalty's gas.[11]

The court of appeals reviewed every argument made by the Commission either in the orders under review or in its brief to that court. In particular, the court held that

[10] Of course, Gulf did not request authorization for total abandonment of its sale to El Paso, since the depletion of its gas supply through expiration of its Waddell Ranch lease merely reduced (by less than one-half) the supply of casinghead gas Gulf had available from all sources covered by its contract with El Paso. Although Gulf's application was filed more than two years ago, the Commission has taken no action on it.

[11] Contrary to the Commission's characterization in its brief at page 10, the court of appeals did not hold that "by virtue of state property law the reversionary mineral interest owners were free to withdraw their gas from interstate commerce without Commission authorization." The court held that Southland Royalty's gas had never been dedicated to interstate service.

Southland Royalty was not a "successor" to Gulf's obligations, because Southland Royalty did not acquire or succeed to Gulf's leasehold rights; rather it owned an independent vested property interest that Gulf never owned or controlled. 543 F.2d at 1138. Similarly, the court of appeals noted that the Commission's reliance on *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960) was misplaced. It pointed out that this Court did not hold in *Sunray* that a producer could dedicate gas which it did not own; this Court merely stated that, since Sunray had commenced interstate deliveries of its gas under an unlimited certificate, Sunray had to deliver all the gas which it had the power to dedicate under its leasehold. 543 F.2d at 1138.

El Paso, California and the Commission sought certiorari and have filed briefs urging reversal.[12]

SUMMARY OF ARGUMENT

The decision of the court of appeals is entirely consistent with "the fundamental premise of the Act" (FPC at 11) that *once* a producer's gas has been *dedicated* to an interstate sale, it may not be withdrawn from that sale without Commission abandonment authorization under Section 7(b) of the Act. The court held that Southland Royalty's gas had never been dedicated to interstate service; therefore, no *dedicated* gas will be released or withdrawn from interstate service as a result of the court's decision.

In so holding, the court of appeals properly rejected the Commission's determination that Gulf had a legal "power to encumber" and did encumber Southland Royalty's mineral fee gas with a dedication to Gulf's interstate sale of its fixed-term leasehold gas to El Paso. The Natural Gas Act did not confer on Gulf the power to dedicate to interstate

[12] Hereinafter cited respectively as (El Paso at ...), (Calif. at ...) and (FPC at ...). The Associated Gas Distributors (AGD) and the Public Service Commission of New York (New York) have filed amicus curiae briefs in support of petitioners, which are hereinafter cited as (AGD at ...) and (NY at ...).

service gas in which it never had any ownership or other interest.

Nothing in the language or legislative history of the Act even suggests the grant of such unprecedented power to a private party. On the contrary, the Act expressly provides that a producer who applies for a certificate to make an interstate sale must be both "able" and "willing" to perform the service he proposes. Gulf was never "able" to perform any interstate service with Waddell Ranch gas to be produced after the expiration of its lease, because it never owned any interest in or had any right to control the disposition of gas produced after the expiration of its fixed-term lease. Gulf undeniably applied for and received a certificate which was limited to the sale of Gulf's leasehold gas. Thus, Gulf never was "willing" and never was found to be "willing" to dedicate Southland Royalty's gas.

The court of appeals correctly held that Southland Royalty had not consented to or ratified an interstate dedication of its gas. As the court noted, "[r]atification implies knowing choice," 543 F.2d at 1139. Yet Southland Royalty "could not have known it would be claimed" that Gulf's dedication of Gulf's gas dedicated Southland Royalty's gas. *Id.* Nor was Southland Royalty's acceptance of fixed royalties on Gulf's sale of Gulf's gas in any way inconsistent with Southland Royalty's position as a mineral fee owner and clearly did not subject Southland Royalty to Commission jurisdiction. *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied* 406 U.S. 976 (1972).

This Court's decisions construing the Natural Gas Act do not suggest, much less hold, that the Act confers on a producer like Gulf the power to dedicate gas which he does not own. *CATCO, Atlantic Refining Co.* v. *Public Serv. Comm'n.*, 360 U.S. 378 (1959) and *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960), establish that once a producer accepts an unlimited certificate and commences deliveries, he must continue to deliver all the gas that he owns and dedicated to his sale when he commenced deliv-

eries of his gas. They also establish that if the producer proposes to make an interstate sale but has not commenced deliveries, it has "an undoubted right to stand firm on its own application and reject the proffered certificate." *Sunray*, 364 U.S. at 141. But none of these decisions even intimates that a producer could dedicate to interstate service gas in which it never had any ownership or other interest.

Moreover, it is clear that Gulf did not derive from property law the power to dedicate Southland Royalty's gas because it is well established that no man can dedicate what he does not own. Therefore, under property law principles, Gulf could not legally deal in or dedicate the mineral fee gas to be found and produced by Southland Royalty after termination of Gulf's fixed-term lease.

The court of appeals also properly rejected the Commission's theory that Southland Royalty "succeeded" to Gulf's dedication. 543 F.2d at 1138. As recognized both by the court of appeals and by the Tenth Circuit in *Phillips Petroleum Corp.* v. *FPC*, 556 F.2d 446 (10th Cir. 1977), a successor-in-interest is one who acquires his predecessor's estate. A successor takes "subject to any benefits and infirmities inherent therein," including an interstate sale dedication. Similarly, a covenant running with the land can only be enforced against a successor-in-interest to the covenantor. Since Gulf never owned any interest in Southland Royalty's mineral fee estate and Southland Royalty did not acquire Gulf's leasehold estate, Southland Royalty's mineral fee is not subject to any benefits and infirmities inherent in Gulf's lease.

Cases construing the Interstate Commerce Act are of doubtful relevance to the issue presented, but insofar as they may be relevant they tend to support the decision of the court of appeals that Gulf's interstate dedication imposes no service obligation on Southland Royalty. If one "carrier by railroad" is performing interstate railway service and leases his operation to another "carrier by railroad" subject to Interstate Commerce Commission jurisdiction, he can be required to resume his own service obligation upon termination of the lease. But if, as in this case, the lessor was not performing an interstate service when he executed the lease, an interstate service undertaken by a lessee imposes no service obligation on the lessor upon the termination of the lease.

The decision of the court of appeals does not impair the Commission's regulatory authority over natural gas *dedicated* to interstate service. In holding that Southland Royalty's gas had never been so dedicated the court did not free any gas which had been dedicated to interstate service. Nor does its decision determine the outcome of any case involving premature termination of an ordinary oil and gas lease capable of lasting indefinitely. In such a case the lessee commits to interstate service all of its leasehold gas but before it has delivered all of its leasehold gas the lease is prematurely terminated by the voluntary action of either the lessor or the lessee. In this case Gulf sold all its leasehold gas to El Paso, and its leasehold estate expired at the conclusion of the term provided in its lease.

Likewise, the court of appeals' decision will not impair the Commission's authority over interstate sales by encouraging future lessors and lessees to enter into previously unknown types of leases, such as short-term leases or leases terminable at will. Lessees have an extremely powerful economic incentive to secure the longest term lease obtainable, which is why oil and gas leases entered into since 1928 last as long as the lessee maintains production in paying quantities. But if some future lessee were to approach the Commission with an application to sell gas attributable to a leasehold interest terminable at will, the Commission can and will protect the interstate market against such an unreliable source of supply by refusing to issue a certificate for the sale, or by conditioning the certificate upon the lessee first obtaining a longer and more stable leasehold interest from the lessor. *Cf. Transco Exploration Co.*, FPC Docket No. CI77-306, issued June 27, 1977.

The Commission's concern to maintain its statutorily authorized control over gas dedicated to interstate service is understandable. However, in holding that Southland Royalty's mineral fee gas was never legally dedicated to interstate service, the court of appeals did not diminish the Commission's control over gas that is so dedicated. The decision below should be affirmed.

ARGUMENT

I. INTRODUCTION

A. The Concept Of Dedication Under The Natural Gas Act.[13]

Under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f, the Commission is empowered to control the terms upon which a producer may initially dedicate its gas by sale to the interstate market and the basis upon which a producer may withdraw from its interstate sale the gas it dedicated to that sale. Section 7(c) provides that before a producer may make an interstate sale of gas attributable to its leasehold interest it must first obtain a certificate of public convenience and necessity from the Commission authorizing the sale.[14] Under Section 7(e), the Commission is to issue a certificate "if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed" but may attach to the certificate "such reasonable terms and conditions as the public convenience and necessity may require."[15]

The Commission cannot force a producer to dedicate its gas to interstate service.[16] Even if a producer applies for

[13] The Commission et al. do not discuss the concept of dedication to interstate commerce under the Natural Gas Act. This omission is particularly noticeable because the controlling issue in this case is whether Southland Royalty's mineral fee gas was dedicated to interstate commerce by Gulf's interstate sale of Gulf's leasehold gas.

[14] Section 7(c), 15 U.S.C. § 717f(c).

[15] Section 7(e), 15 U.S.C. § 717f(e).

[16] The Commission itself recently reiterated this fundamental limitation on its authority. *See, e.g., Cities Service Oil Co.*, Opinion No. 820, FPC Docket Nos. CI75-191 and CI75-489, issued September 20, 1977, at 6.

a certificate to make an interstate sale of its gas, it has no obligation to accept a certificate with conditions attached by the Commission, but has "an undoubted right to stand firm on its own application and reject the proffered certificate." *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 141 (1960). But if the producer initiates such a certificated sale of the gas attributable to its leasehold interest, the producer thereby dedicates its leasehold gas to interstate service, and under Section 7(b) it must continue deliveries until its available supply of natural gas is depleted to the extent that the continuance of its sale is unwarranted.[17]

When a producer makes an interstate sale of its gas it undertakes to sell, and thereby dedicates to interstate service, *its* leasehold interest in whatever gas is produced from a particular field or area during the term of its lease.[18] In many cases two or more producers own fractional shares of the leasehold interest in gas produced from a particular field or area. It is not unusual for certain producers to make interstate sales of the gas attributable to their respective shares of the leasehold interest in a given field while the remaining producers make intrastate sales of the gas attributable to their shares of the leasehold interest in the same field. The Commission has never questioned such "split-stream" sales; it has consistently recognized the right of each producer to choose whether to make an interstate or intrastate sale of its own gas. (*See, e.g.*, A. 710).

[17] Section 7(b), 15 U.S.C. § 717f(b). Thus in *CATCO, Atlantic Refining Co.* v. *Public Serv. Comm'n*, 360 U.S. 378, 389 (1959), this Court stated:

> Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

[18] Under an ordinary oil and gas lease the leasehold interest continues indefinitely, *i.e.*, so long as oil or gas is produced in paying quantities. By contrast Gulf's Waddell Ranch leasehold interest expired on the date prescribed in its lease. Of course, such fixed-term oil and gas leases have not been used for many years. *See* note 1, *supra*.

Moreover, it is not unusual for a producer to vertically limit the leasehold gas it dedicates to an interstate sale to its interest in gas produced from specified formations or from all formations located between the surface and a specified depth. If a producer so limits its initial dedication, its interest in gas produced from other formations or depths is unquestionably free of any interstate dedication. Likewise, it is not unusual for a producer to horizontally limit the leasehold gas it dedicates to an interstate sale to the gas produced from a specified portion of a leasehold held by the producer. For example, if the producer holds a lease on 1,000 acres, it may choose to dedicate only its leasehold interest in 500 acres of the tract. It is unquestioned that if the producer so limits its interstate dedication of gas, it remains free to make an intrastate sale of the leasehold gas produced from the remaining 500 acres of the tract covered by its lease.

In the instant case, there was a severance of interests in gas underlying the Waddell Ranch, between Gulf and Southland Royalty. The severance between a fixed-term leasehold interest and a mineral fee interest is a severance in time,[19] rather than a horizontal or vertical severance in space. But as noted by the court below the severance here was just as complete as if it had been spatial:

> The estates in the single tract are as separate as though they subsisted in separate parcels of land.

543 F.2d at 1137.

If Gulf and Southland Royalty had each owned a fifty percent leasehold interest in the Waddell Ranch at the same time, there could be no claim that Gulf's interstate sale of Gulf's gas dedicated Southland Royalty's gas to interstate service under the Natural Gas Act. (A. 710). But in this case the Commission held that a contrary result

[19] The legal interest in perpetuity in all oil and gas under specific acreage is commonly called the "mineral fee interest" and is clearly distinguishable from the leasehold interest created by an oil and gas lease because under such a lease "[t]he lessee's privileges of taking are limited by the duration of the lease." 1A W. Summers, The Law of Oil & Gas § 132 at 210 (1959).

should be reached where Gulf owned a fifty year fixed-term leasehold and Southland Royalty contemporaneously owned an entirely separate mineral fee interest under which its gas was to be produced and sold after Gulf's lease expired. The Commission held that Southland Royalty's gas was dedicated to interstate service because Gulf had made an interstate sale of Gulf's leasehold gas. Whether Gulf thus dedicated Southland Royalty's gas is the issue before this Court.

B. The Controlling Issue Is Whether Gulf Dedicated Southland Royalty's Gas.

On the basis of its holding that Southland Royalty's Waddell Ranch gas had been dedicated to interstate service, the Commission prohibited Southland Royalty from selling such gas to the intrastate purchaser of its choice, without first obtaining abandonment authorization under Section 7(b). If Southland Royalty's gas had in fact been dedicated to El Paso, then the Commission would be correct: Southland Royalty would have to obtain abandonment authorization in order to sell its gas to another purchaser. Southland Royalty recognizes that "once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval."[20]

The Commission claims that the court of appeals attacked this "fundamental premise of the Act" (FPC at 11) by holding that Southland Royalty et al. are "free to withdraw their gas from interstate commerce." (FPC at 10). This simply misstates the court's holding; the court of appeals held that Southland Royalty's gas is not and never was dedicated to interstate commerce.[21] Similarly,

[20] *CATCO, Atlantic Refining Co.* v. *Public Serv. Comm'n*, 360 U.S. 378, 389 (1959).

[21] The court of appeals noted the Commission's holding that Southland Royalty's "reversionary interest had been dedicated to interstate commerce by the lessee." The court then framed the question presented as whether the lessee, "by making certificated

El Paso claims that this case involves the "question of whether the expiration of a lease frees [Southland Royalty's gas] from the interstate market" (El Paso at 11), and California claims that the issue "is the extent to which natural gas reserves, once dedicated to interstate commerce, can be withdrawn from interstate commerce" (Calif. at 10).[22] On the contrary, the issue is whether Southland Royalty's gas has ever been dedicated to the interstate market. If Southland Royalty's gas was never dedicated, the court of appeals' decision does not "free" it or permit it to be "withdrawn" from interstate dedication.

More specifically, the issue before this Court is whether Southland Royalty's mineral fee gas was dedicated to interstate service *as a result of Gulf's sale of Gulf's leasehold gas.* It is uncontested that Southland Royalty has not itself made any interstate sale of its mineral fee gas.[23] It is also settled beyond dispute that Southland Royalty was not a "natural-gas company" performing an interstate "service" subject to the Commission's jurisdiction

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sales of leasehold natural gas in interstate commerce, thereby dedicate[d] to interstate commerce gas which remains in the ground" after the expiration of the lease. The court answered this question in the negative. 543 F.2d at 1136.

[22] Since these "withdrawal claims" merely beg the dedication question, it is perhaps unimportant that the Commission et al. grossly exaggerate the amount and significance of the "dedicated" gas they claim will be withdrawn. First, this case involves a miniscule fraction of U.S. marketed natural gas production. Southland Royalty pointed this out in its brief in opposition to the petitions for certiorari (at 11, n.27) and none of the petitioners has attempted to refute this calculation. Second, the other three fixed-term lease expiration cases referred to by the Commission et al. involve, cumulatively, less gas than the present case. (The Commission et al. attempt to exaggerate the number of such cases by citing separately every Commission and court docket concerning them. They do not, however, deny that in fact there are only three such cases.) Third, the gas is not "critically needed" but would in fact go for what California admits are "low-priority customers." (Calif. Pet. at 7).

[23] Except, of course, for the involuntary sale that Southland Royalty is making under compulsion of the Commission's orders and under a protective order which provides that the involuntary sale does not itself constitute a dedication.

under the Natural Gas Act simply because it received royalties paid by a lessee who was making an interstate sale. *Mobil Oil Corp.* v. *FPC,* 463 F.2d 256 (D.C. Cir. 1971), *cert. denied,* 406 U.S. 976 (1972).[24] Finally, it is undisputed that Gulf sold only its leasehold gas to El Paso, not Southland Royalty's mineral fee interest gas.[25]

In short, the court of appeals can be reversed and the Commission's orders sustained only if Gulf had "power to encumber" Southland Royalty's mineral fee interest with an interstate dedication and exercised this alleged power by selling its own leasehold gas. The Commission claims such power is conferred by the Natural Gas Act. That is, the Commission contends that under the Natural Gas Act, a producer who makes an interstate sale dedicates all gas from the acreage in question, regardless of limitations on his ownership interest, and thereby creates an encumbrance which outlasts the term of his lease. Nothing in the Act or its legislative history supports such a radical construction.

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[24] New York intimates that Southland Royalty is attempting to exercise a "right to terminate an ongoing sale," thereby "converting [its] royalty interest into that of a participant in the sale," and thus possibly qualifying under *Mobil* as a "natural-gas company." (N.Y. at 4.) The suggestion is incorrect. Gulf's lease expired. Southland Royalty did not "convert" its royalty interest into a share of Gulf's lease or Gulf's sale. Southland Royalty is not attempting to terminate Gulf's sale, which continues pursuant to its terms through Gulf's delivery of gas from other leasehold interests. Gulf never sold any Waddell Ranch gas to El Paso other than its leasehold gas, and when Gulf's lease expired, Gulf had no more such gas to sell.

[25] There is no dispute that "Gulf attempted no dedication of gas beyond the interests it owned." (A. 457).

II. GULF COULD NOT ENCUMBER SOUTHLAND ROYALTY'S GAS WITH AN INTERSTATE SERVICE OBLIGATION.

A. Under The Natural Gas Act, A Lessee Cannot Dedicate Gas He Does Not Own.

1. Language and legislative history.

The Commission et al. argue that under the Natural Gas Act a lessee has the power to dedicate to interstate service gas in which it has never had any ownership or other interest. Specifically, they argue that simply by making an interstate sale of its leasehold gas, Gulf dedicated Southland Royalty's gas to an interstate "service" which, under Section 7(b), "[n]o natural-gas company shall abandon" without Commission authorization. Consideration of whether Southland Royalty is a "natural-gas company" and whether its gas was dedicated by Gulf to interstate service "must of course begin with the language of the Act itself."[26]

A "natural-gas company" is expressly defined in the Act as a "person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 15 U.S.C. § 717a(6). Gulf was found in 1956 to be a "natural-gas company" with respect to its Waddell Ranch gas because Gulf engaged in an interstate sale of its leashold gas to El Paso. But Southland Royalty has not at any time been a "natural-gas company" with respect to its Waddell Ranch gas, because it neither engaged in Gulf's interstate sale of Gulf's gas nor engaged in any sale of its own gas to El Paso (except the involuntary sale it is making pursuant to the Commission's protective order).

"Service" is not expressly defined in the Natural Gas Act. This Court has, however, indicated that "service" refers to an interstate "transportation or sale of natural gas" for which Section 7(c) requires any "natural-gas company" to obtain a certificate of public convenience and

[26] *Chemehuevi Tribe of Indians* v. *FPC*, 420 U.S. 395 (1975).

necessity. *See Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 149-50 (1960). The Commission maintains that, when Gulf applied for and received a certificate to make an interstate sale of its Waddell Ranch leasehold gas to El Paso, Gulf thereby committed to interstate "service" all gas which might ever be produced from the Waddell Ranch, including Southland Royalty's gas to be found and produced after the expiration of Gulf's lease.

The very language of Section 7(e), which governs Commission action upon certificate applications, refutes any such suggestion. Under Section 7(e), the Commission cannot issue a certificate unless it finds that "the applicant is able and willing properly to do the acts and to perform the service proposed . . . ." If, as the Commission contends, the "service proposed" was that of selling *all* gas ever found and produced from the Waddell Ranch, Gulf was never "able" to perform the service proposed. Not even the Commission contends that it found in 1956 that *Gulf* could sell Waddell Ranch gas to El Paso after the expiration of Gulf's lease.

Moreover, Gulf was never "willing" and was never found to be "willing" to sell Southland Royalty's gas to El Paso in interstate commerce. Gulf applied for a certificate covering only "Seller's surplus residue gas." (A. 3, 43). Gulf knew it would have no "Seller's surplus residue gas" attributable to the Waddell Ranch lease upon the expiration of its lease. (It does, of course, have such gas from other sources and, therefore, continues to sell "Seller's surplus residue gas" to El Paso.) Accordingly, Gulf never attempted any dedication of Waddell Ranch gas beyond the leasehold gas it owned. (A. 457).

The Commission itself has honored this construction of the Act in other cases. In a recent decision, it recognized that a producer cannot be forced to "dedicate more to interstate commerce than it wanted to."[27] If that is so,

[27] *Cities Serv. Oil Co.*, Opinion No. 820, FPC Docket Nos. CI75-191 and CI75-489, issued September 20, 1977, at 6. The case involved

surely, Gulf cannot have initially dedicated more to interstate commerce than Gulf either owned or intended to dedicate.

Thus, the Commission's interpretation of the Natural Gas Act — that it authorized Gulf to dedicate Southland Royalty's gas to interstate commerce — has no support in the language of the Act. Gulf was neither "able" nor "willing" to commit Southland Royalty's mineral fee interest to Gulf's sale to El Paso.

Further, an interpretation of the Act under which a private party like Gulf could dedicate to interstate service property in which it had no ownership or other interest would raise a constitutional question of taking of property without due process of law. Such a construction should not be read into the Act.

The legislative history of the Act does not "add a gloss to the operative language of the statute quite different from [the] commonly accepted meaning"[28] of the terms "able" and "willing." The Act set out to "provide for regulation along recognized and more or less standardized lines. There is nothing novel in its provisions . . . ."[29] There is no reason to doubt that these standardized provisions included the concept by which service had always been "dedicated to the public under common law."[30] There is nothing in the legislative history even to suggest the radical innovation of authorizing a lessee to dedicate more than his leasehold interest to interstate service.

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sales from offshore federal waters by two producers who initially "dedicated one-half of their respective interests and no more." The Commission Staff urged the Commission to require the producers to continue to sell the rest of their gas, from the other one-half leasehold interest, at the same old contract price. The Commission stated that if it were to follow this suggestion, ". . . then we would be in a position of having forced the producers to dedicate their retained one-half interest to [the pipeline]. *This we cannot do.*" *Id.* (emphasis supplied).

[28] *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 (1976).

[29] H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937).

[30] *Cf. Hearing on H.R. 4008 Before the House Comm. on Interstate & Foreign Commerce*, 75th Cong., 1st Sess. 40 (1937) (Testimony of Harry R. Booth).

2. **Sunray, Sun and CATCO.**

Unable to support their position by reference to the language or the legislative history of the Act, the Commission et al. rely on language from this Court's decisions in *Sunray*, 364 U.S. 137, and *Sun Oil Co.* v. *FPC*, 364 U.S. 170 (1960), which in turn quote from *CATCO, Atlantic Refining Co.* v. *Public Serv. Comm'n*, 360 U.S. 378 (1959). This reliance is misplaced. These cases simply state that a producer who makes an interstate sale under a certificate of public convenience and necessity granted pursuant to Section 7(e) must sell all *his* reserves committed to that sale, unless he first obtains abandonment authorization.[31]

The Commission et al. rely particularly on *Sunray*.[32] This Court has recently summarized its holding in *Sunray*: the Commission "had authority to *tender* a certificate of public convenience and necessity without time limitation to a producer who applied for a certificate authorizing sales for 20 years only," as provided in its contract.[33] That is, *Sunray* did not even hold that the Commission could force a producer to sell its *own* gas to an interstate pipeline, much less gas in which the producer never had any ownership or other interest.

On the contrary, the Court recognized that a producer/certificate applicant has an "undoubted right to stand firm on its own application, and reject the proffered certificate." *Sunray*, 364 U.S. at 141. The Court pointed out that Sunray "did not avail itself" of this right, but "accepted the Commission's certificate and commenced deliveries of gas under it." *Id.* Having done so, Sunray dedicated all its gas, and "once so dedicated" Sunray's gas could not be withdrawn from the interstate service Sunray

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[31] While discussing these cases the Commission admitted that it had "discovered no case directly in point." (A. 605).

[32] California even claims that the present case is "explicitly covered" by *Sunray* (Calif. at 20).

[33] *FPC* v. *Moss*, 424 U.S. 494, 503 (1976) (emphasis supplied).

had commenced. *Id.* at 156, quoting from *CATCO*, 360 U.S. at 389.

But Sunray did not thereby dedicate any gas other than its own gas. The case involved only Sunray's attempt to retain for the future a right to make a new sale of its *own* gas — the gas attributable to "all lands, leaseholds and units or parts thereof owned by seller" in a defined area and committed to the contract. *Sunray* v. *Mid-Continent Oil Co.*, 19 FPC 618, 624, 635 (1958). *Sun* and *CATCO* are similar in this crucial respect.

In addition, *Sunray*, *Sun* and *CATCO* each involved *ordinary* oil and gas leases,[34] under which the leasehold estate remains in effect as long as gas is produced in paying quantities.[35] Thus, in each of these cases, once the producer/certificate applicant had "so dedicated" his leasehold gas to interstate service, there could be no withdrawal of "that supply" from interstate service unless he first obtained abandonment authorization. These cases do not hold or even suggest that when the owner of a rare fixed-term lease, like Gulf, commences a sale of its leasehold gas under a Commission certificate, it also dedicates to interstate commerce the mineral fee owners' gas.

The Commission et al. recognize that *Sunray* involved a producer whose leasehold ownership interest continued indefinitely but whose contract for the sale of his leasehold gas to his pipeline purchaser expired. They contend, however, that the result is the same where a lessee commences an interstate sale to a pipeline and his lease expires, citing *Rayne Field, United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). The Commission says that the producers in *Rayne Field* commenced production and interstate sales of gas from their leases, became subject to regulation under *Phillips*, attempted to evade regulation by substituting the pipeline as owner of the leases, and were held

[34] *See* the record in each case: *Sunray*, R. 15-17, 25, 26; *Sun*, R. 62-71; *CATCO*, R. 489, 494-96.

[35] 2 E. KUNTZ, LAW OF OIL & GAS § 26.1 at 244 (1964); 1A W. SUMMERS, THE LAW OF OIL & GAS § 153 at 381 (1959).

bound not to withdraw their dedicated gas "regardless of intervening changes in property rights" and "regardless of of 'technical concepts of local law.'" (FPC at 11, 18 n.20).

This is a gross mischaracterization of the facts and holding in *Rayne Field*. What actually occurred was that, three years after *Phillips*, the lessees who developed the Rayne Field entered into conventional gas contracts to sell their Rayne Field gas to an interstate pipeline. They duly applied for certificates, but they did not commence interstate deliveries. When the court of appeals in *CATCO* held that a price even lower than their proposed price was too high, they withdrew their applications and sold and assigned their Rayne Field leases to the pipeline, which commenced taking the gas into its interstate pipeline system. This Court held that the producers' sale to an interstate pipeline of their leasehold interests in proven and substantially developed reserves amounted to an interstate sale of gas for resale, and that the Commission could therefore regulate the leasehold sale. Obviously *Rayne Field* is a far cry from the "very situation presented" (FPC at 18 n.20) in *Sunray*, much less the situation presented in this case.

To the extent that any of these cases do shed light on whether Gulf could dedicate Southland Royalty's gas, they suggest that it could not. Southland Royalty has never applied for a certificate for the interstate sale of its Waddell Ranch gas, nor has it had any obligation to apply for a certificate, since it has never chosen to make an interstate sale of its gas. Thus it has never had the opportunity to exercise the undoubted right of a producer which proposes to engage in an interstate sale of its gas "to stand firm on its own application, and reject the proffered certificate," and market its gas elsewhere if it chooses.

The Commission responds that Southland Royalty has in effect had a chance to decide where to sell its mineral fee gas, because it was not "powerless to prevent Gulf

from dedicating the leasehold gas" to El Paso. (FPC at 20). This is wrong, and the Commission knows it is wrong. The Commission itself told the court of appeals that Southland Royalty "could not prevent Gulf's total dedication of surplus residue gas to El Paso." (FPC 5th Cir. Br. at 16-17). Furthermore, the Commission's response is irrelevant. As noted by the court of appeals, Southland Royalty could not know it was supposed to intervene in opposition to Gulf's application for a certificate covering Gulf's sale of *leasehold* gas, or reject royalties on the sale of Gulf's *leasehold* gas — because Southland Royalty had no reason to believe that Gulf was thereby dedicating the *mineral fee* gas, which Gulf did not own and was not attempting to dedicate. 543 F.2d at 1139.

3. **Southland Royalty is not a "successor" to Gulf's dedication of Gulf's leasehold gas.**

The Commission also claims that Southland Royalty is a "successor-in-interest" to Gulf,[36] and therefore is bound by Gulf's dedication of Gulf's leasehold gas (FPC at 20), citing Commission decisions in *Cumberland Natural Gas Co.*, 34 FPC 132 (1965), and *Blair-Vreeland*, 53 FPC 843, Opinion No. 724 (1975), *rev'd sub nom. Vreeland* v. *FPC*, 528 F.2d 1343 (5th Cir. 1976). The short answer to this claim is that Southland Royalty is not a successor to Gulf's leasehold interest. 543 F.2d at 1138.

[36] The Commission has telegraphed its own uncertainty about this theory by vacillating throughout this case on whether to portray Southland Royalty as a "successor" to Gulf. In its initial opinion, the Commission said that upon the expiration of Gulf's lease Gulf's "rights pass" to Southland Royalty, but that "gas may not be withdrawn from interstate commerce by the assignment of leases from one lessee to another." It then cited its own successor-in-interest decisions. (A. 606). But the Commission then immediately stated that "we do not rest our conclusion on these cases." (*Id.*) On rehearing, the Commission reversed its field and said that it was holding that service cannot be "discontinued by transfer to a successor interest." (A. 711). In the court of appeals, the Commission dropped the successor argument again, never mentioning it. The Commission now advances the claim once more, though with apparent lack of confidence: its principal discussion is appended to its Interstate Commerce Act section. (*See* FPC at 28-29).

The two cases cited by the Commission, like every other Commission successor-in-interest decision,[37] involved the assignment of an ordinary leasehold interest under which the lessee's interest continued indefinitely. That is, the lessee had committed his leasehold interest to interstate service, and later assigned that very same leasehold interest to another producer. When an assignee voluntarily acquires a dedicated leasehold estate, he "steps into the shoes of his predecessor [and] takes the properties . . . subject to any benefits and infirmities therein."[38] Indeed, normally the assignee expressly assumes his assignor's obligations.[39] Since the assignee voluntarily acquires a dedicated lease, he voluntarily undertakes the obligation of making an interstate sale of the leasehold gas.

In this case, Gulf dedicated to El Paso the casinghead gas attributable to Gulf's fixed-term leasehold interest. Gulf sold all of this leasehold gas to El Paso. Gulf's lease expired. Southland Royalty did not acquire Gulf's lease, voluntarily or otherwise; Gulf's leasehold rights were not assigned or otherwise transferred to Southland Royalty. In short, Southland Royalty has never owned or acquired any part of the Waddell Ranch leasehold interest which Gulf dedicated to interstate service. Thus, it cannot be held that Southland Royalty stepped into Gulf's shoes or is a "successor" to Gulf or is in any way bound by Gulf's dedication of Gulf's lease.

[37] *See, e.g., Mitchell Energy Corp.*, 53 FPC —, Opinion No. 733, FPC Docket No. CI75-236, issued June 11, 1975, *aff'd*, 533 F.2d 258 (5th Cir. 1976); *Graridge Corp.*, 30 FPC 1156 (1963).

[38] *Graridge Corp.*, 30 FPC at 1162.

[39] In *Mitchell Energy Corp., supra* n. 37, for instance, Mitchell Energy acquired a lease by assignment under which it agreed to perform "all of the future obligations which would have been validly imposed on assignor by any contract, lease, franchise, license, certificate, undertaking or agreement relating to the property or interests hereby transferred and assigned." Opinion No. 733 at 2. Likewise, in *Blair-Vreeland*, "Vreeland's agreements with [the assignor of its leasehold interest] were and are explicitly subject to existing encumbrances." Opinion No. 724 at 12.

Nor can the Commission show that Southland Royalty is a successor-in-interest to Gulf by asserting (FPC at 8 and 16 n.17) that Gulf's service obligation "is like an ancient covenant running with the land" and citing *Hunt* v. *FPC*, 306 F.2d 334, 342 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964). A common-law covenant can be enforced against a successor-in-interest to the covenantor, but not against one who does not succeed to the covenantor's estate.[40] That is, under property law the "land" with which a lessee's interstate service obligation runs is his leasehold interest.[41] Southland Royalty did not succeed to Gulf's leasehold estate, and therefore is not bound by Gulf's dedication of Gulf's gas.

The distinction between the successor-in-interest cases and this case was clearly drawn in the decision below, 543 F.2d at 1138, and by the Tenth Circuit in a very recent decision, *Phillips Petroleum Co.* v. *FPC*, 556 F.2d 466, 470-71 (10th Cir. 1977). The *Phillips* decision applies the successor-in-interest doctrine to a "farmout" type of lease assignment, where the Commission itself originally had refused to apply it.[42]

In *Phillips*, Phillips farmed out (entered into a contract to assign) its leasehold interest in certain acreage to Goldston. Goldston drilled on the lease it acquired from Phillips, thus earning the right under the contract to an assignment

[40] *See* 2 AMERICAN LAW OF PROPERTY § 9.15 at 384 (1952): "There has never been any serious question of the rule that the assignee of the covenantor must succeed to the estate of the covenantor in order to be liable upon the burden of the covenant." *See generally* CLARK, REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH THE LAND" at 111-15 (2d ed. 1947).

[41] In *Hunt*, the court of appeals spoke of land, not a lease, because that case, like every case prior to this one, involved an ordinary lease, capable of lasting indefinitely. Thus, the interstate covenant, although it ran with the lease, appeared to run with the land because it lasted as long as the reserves in question lasted.

[42] *El Paso Natural Gas Co.* v. *Bass*, 48 FPC 1269 (1972). Contrary to the Commission's statement (FPC at 8 n.10), *Bass* did not involve a lease which "gave the lessor the option, after the lessee recovered its drilling costs, to receive in lieu of royalty a one-half

of Phillips' lease. Goldston found gas, was assigned Phillips' leasehold interest and sold the gas attributable to the assigned leasehold to an interstate pipeline. In the farmout contract, Phillips retained an overriding royalty interest (a royalty in addition to the lessor's royalty) with an option to convert its overriding royalty into a partial working interest (a share of the original lease) if the well "paid out" (produced enough to cover Goldston's costs). The well paid out, and Phillips subsequently elected to convert its override, thus regaining by reassignment a partial share of the original leasehold that it had transferred to Goldston. Phillips then sought to sell its share of the leasehold gas to the same interstate pipeline at the higher "new gas" price. The Commission denied Phillips the higher price, holding that Phillips was a successor-in-interest to Goldston's dedication of the entire lease.

The Tenth Circuit affirmed, pointing out that Phillips was a "subsequent holder" of leasehold rights acquired from Goldston, who had encumbered the leasehold estate, and therefore was subject to all of the burdens validly created by its predecessor in interest. For this proposition, the Tenth Circuit cited the court of appeals' decision in this case with approval. *See* 556 F.2d at 470-71, relying on and agreeing with *Southland Royalty Co.* v. *FPC*, 543 F.2d 1134, 1138 (5th Cir. 1976). The Tenth Circuit also pointed out that *"Southland* is distinguishable from the present case," because in *Phillips* Goldston had the power to dedicate the entire lease, including the portion it later reassigned to Phillips, whereas in this case Gulf never had

[illegible]erest in the gas produced." Like *Phillips*, which overruled *Bass*, *Bass* actually involved a contract between a lessee and another producer to whom the lessee agreed to assign his lease, retaining the option to require a partial reassignment. As in *Phillips*, the assignee dedicated the entire leasehold interest to an interstate sale. The assignor then exercised his contractual option to require a partial reassignment, and subsequently tried to make a new sale of the gas attributable to the reassigned share of the dedicated leasehold.

the power to dedicate Southland Royalty's completely separate property interest. 556 F.2d at 470.[43]

4. Southland Royalty did not ratify or consent to dedication of its gas.

In effect conceding Gulf's legal inability to dedicate Southland Royalty's gas to interstate service, the Commission falls back on an argument that Southland Royalty consented to or ratified Gulf's alleged dedication of Southland Royalty's gas. In particular, the Commission refers to Southland Royalty's acceptance of royalties on Gulf's sale and lack of opposition to Gulf's certificate application. *See* FPC at 9, 20, 34. The court of appeals correctly recognized that neither Southland Royalty's lack of opposition to Gulf's certificate application nor its acceptance of a fixed royalty could possibly be construed as "ratifying" the interstate sale or authorizing the interstate dedication of Southland Royalty's gas. As the court below pointed out, "[r]atification implies knowing choice," 543 F.2d at 1139. However, Southland Royalty "could not have known it would be claimed" that Gulf's dedication of Gulf's gas dedicated Southland Royalty's gas. *Id.* Moreover, Southland Royalty "could not control" Gulf's sale of Gulf's leasehold gas and by accepting the fixed royalty provided by the lease on any such sale Southland Royalty took no action inconsistent with its position as a mineral fee owner or which subjected Southland Royalty to Commission jurisdiction. *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972).[44] The Commission tries to distinguish

[43] That is, the Tenth Circuit recognized that *Southland* involved two entirely separate and independent property interests; whereas *Phillips* involved an assignment of a leasehold interest, the interstate dedication of that same leasehold interest by the assignee, and the reassignment of a part of the dedicated leasehold interest to the assignor.

[44] In *Mobil Oil Corp.*, *supra* the court of appeals reversed the Commission's assertion of jurisdiction over royalty owners which received royalty payments based on interstate sales of gas by their lessees. The court held that a royalty owner is not a "natural-gas company" as defined in the Natural Gas Act because he does not engage in a "sale" in interstate commerce.

Certiorari was recently denied in *Lightcap* v. *Mobile Oil Corp.*, 562 P.2d 1 (Kan.), *cert. denied*, 46 U.S.L.W. 3219 (U.S. Oct. 3, 1977) (No. 76-1694), in which the Kansas Supreme Court relied on *Mobil Oil Corp.* to support its holding that courts have jurisdiction to order royalties to be based on a higher rate than the rate the Commission approves for interstate sales of gas by the lessee.

Mobil Oil Corp. on the ground that "[t]he court did not consider whether, on termination of the leases, such former lessors who succeed to the interest of their natural gas company lessees would be natural gas companies within the meaning of the Act . . ." (FPC at 29). Of course, Southland Royalty did not succeed to Gulf's leasehold interest or Gulf's sale of Gulf's leasehold gas, so the assumption underlying the Commission's attempted distinction is wrong. Further, the precise holding in *Mobil Oil Corp.* was that a lessor which demands and receives market value royalties on its lessee's interstate sale of leasehold gas does not thereby become a "natural-gas company" engaged in the lessee's interstate sale. The Commission does not even try to explain how, in the light of *Mobil Oil Corp.*, it can argue that Southland Royalty became a "natural-gas company" engaged in Gulf's interstate sale by accepting below-market value royalties on Gulf's sale of Gulf's leasehold gas.

B. Under Well Established Property Law, A Lessee Cannot Dedicate Gas He Does Not Own.

In the court of appeals, the Commission's principal argument was that Gulf had the power *under Gulf's lease* to encumber Southland Royalty's mineral fee estate with an interstate dedication.[45] In response to the Commission's argument, the court of appeals concluded that, under well established principles of property law, Gulf as a tenant for years had no power to legally deal in or dedicate South-

[45] Thus, the Commission informed the court of appeals that:

> What the Commission has determined is that Gulf's leases empowered it to dedicate to interstate service all the surplus residue gas from the subject acreage, and the "service" obligation continued despite the termination of Gulf's leases.

land Royalty's estate.[46] This decision is demonstrably correct.

It is universal Anglo-American real property law that one who has a present interest in real property which is limited in duration cannot enter into agreements that are binding upon the reversioner. *See, e.g.*, 2 R. POWELL, THE LAW OF REAL PROPERTY ¶ 247 [1] (Rohan ed. 1977). This doctrine has been described by one eminent authority as a "self-evident principle."[47] The self-evident principle that one cannot encumber a property interest one does not own has been applied in every context in which the question has arisen, and in every jurisdiction. It applies to fiduciaries, including executors, administrators, guardians and trust-

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FPC 5th Cir. Br. at 16-17. Likewise, the Commission asserted that:

> In the instant case, Gulf had complete authority under the lease to dedicate all the gas reserves of the Waddell and Goldsmith Fields and did so.

Id. at 17-18. Even now, the Commission asserts that "Gulf clearly had authority under its leases to develop and sell *the gas* to interstate purchasers." (FPC at 17, emphasis supplied). The question of course is whether Gulf had authority to sell and dedicate Southland Royalty's gas – gas produced after Gulf's lease terminated.

[46] This approach would have been reasonable even if the Commission had relied on the Natural Gas Act: " 'The great body of law in this country which controls acquisition, transmission, and transfer of property, and defines the rights of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state.' . . . This is particularly true with respect to real property." *State Land Board* v. *Corvallis Sand & Gravel Co.*, 429 U.S. 363, 378-79 (1977).

[47] 1 H. TIFFANY, THE LAW OF REAL PROPERTY § 153 at 247 (3d ed. 1939). Tiffany states this principle as follows:

> In the absence of a statutory power or of an express power to that effect in the creation of the estate, one having a limited estate in land cannot, as against the person entitled in reversion or remainder, create an estate to endure beyond the normal time for termination of his own estate.

As detailed in Part II A. of this brief, *supra* at 16-27, Gulf had no statutory power to create an estate that could endure beyond the normal time for the termination of its fixed-term lease.

ees,[48] life tenants[49] and lessees for a term of years,[50] including a mineral lessee for a term of years.[51]

From the principle that one cannot encumber what one does not own, it follows that one cannot dedicate what one does not own. Thus, " . . . a person cannot dedicate interests over which he has no control . . . ." 4 H. TIFFANY, THE LAW OF REAL PROPERTY § 1100 (3d ed. 1975). In short, under unquestioned principles of property law, Gulf could not have dedicated to interstate service Southland Royalty's gas.

The property law principle under which Gulf could not dedicate Southland Royalty's gas is no mere matter of "local Texas law." On the contrary, as the court of appeals pointed out, it is "black letter law," applicable everywhere. 543 F.2d at 1137. At no time in this proceeding have the Commission et al. cited a single case from any jurisdiction which shows that Gulf had the power under property law to dedicate Southland Royalty's mineral fee to interstate service. Finally, this principle is no "technical legal dis-

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[48] *See O'Connor* v. *Chiascione*, 130 Conn. 304, 33 A.2d 336 (1943) and cases cited in Annot., 95 A.L.R.2d 258, 293-96 (1964) (executors and administrators); *Davis* v. *Kressly*, 80 S.D. 254, 122 N.W.2d 219 (1963) and cases cited in Annot., 6 A.L.R.3d 570 (1966) (guardians); *Patterson* v. *Polk*, 229 Ark. 272, 317 S.W.2d 286 (1958); *Wingert* v. *T. W. Phillips Gas & Oil Co.*, 398 Pa. 100, 157 A.2d 92 (1959) and cases cited in Annot., 67 A.L.R.2d 978 (1959) (trustees).

[49] *See, e.g., Haywood* v. *Briggs*, 227 N.C. 108, 41 S.E.2d 289, 171 A.L.R. 480 (1947). "The life tenant could not create an estate to endure beyond the termination of her own estate . . . ." 41 S.E. 2d at 292. *See generally* 2 R. POWELL, THE LAW OF REAL PROPERTY ¶ 203[3] at 130-31 (Rohan ed. 1977).

[50] *See* 2 R. POWELL, THE LAW OF REAL PROPERTY ¶ 247[1] (Rohan ed. 1977).

[51] "The owner of a term for years cannot create an interest in land to endure beyond the term. It would follow that the owner of minerals could not create an interest to endure beyond his fixed term." 2 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 332 at 117 (1975).

tinction" but involves fundamental property law of universal applicability.[52]

III. THE HOLDING OF THE COURT OF APPEALS IS CONSISTENT WITH SETTLED CONSTRUCTION OF THE INTERSTATE COMMERCE ACT.

Unable to find support for its position in the language or legislative history of the Natural Gas Act, or in the cases construing it, the Commission for the first time argues that the holding of the court of appeals is contrary to "settled construction" of the "parallel" abandonment provision of the Interstate Commerce Act, Section 1(18), 49 U.S.C. § 1(18).[53] This argument involves two contentions: First, that Sections 7(b) and 1(18) and the two industries are parallel in all material respects; second, that under the Interstate Commerce Act a lessee who initiates interstate railroad service thereby dedicates his lessor's interest to interstate service. Both contentions are erroneous.

A. Railroad Leases, Service And Abandonments Differ Materially From Natural Gas Leases, Interstate Producer Sales And Abandonments.

The provisions of Section 7(b) and 1(18) are not "parallel."[54] The differences are substantive. For instance, under

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[52] "[W]hen anyone, including the Federal Government, goes into a State and acquires real property, the nature and extent of the rights created are to be determined, in the absence of a specifically applicable federal statute, by the law of the State." *United States* v. *Little Lake Misere Land Co.*, 412 U.S. 580, 605 (1973) (Stewart, J., concurring in the judgment). The holding of the Court was that Louisiana could not retroactively deprive the United States of a possibility of reverter that the United States had retained when it executed a mineral lease on acreage the United States owned.

[53] The Commission did not raise this argument until it petitioned for certiorari.

[54] It is also incorrect to contend that Section 7(b) "originated with" and was "modeled on" the proposed Benton amendment, which Benton said was drawn from Section 1(18), to H.R. 11662, 74th Cong., 2d Sess. (1936), precursor of the Natural Gas Act. The Benton amendment to H.R. 11662 was never adopted, and in fact Section 7(b) originated with an earlier bill, H.R. 5423, 74th Cong., 1st Sess., § 305(b) (1935), whose language is very different from the Benton amendment.

Section 7(b), only the "natural-gas company" which is performing the "service" of making an interstate sale may obtain authorization to abandon its sale. But under Section 1(18) abandonment of a railroad's service may be obtained by any party, including the railroad's lessor.[55] This and other statutory differences result from fundamental differences between the uses of leases in the two industries.

Almost every railroad is an interstate "carrier by railroad" which throughout its operations is subject to Interstate Commerce Commission (ICC) jurisdiction.[56] Early in their history, such railroads entered into long, usually fixed-term leases "as a convenient means of combining two or more independently operated railroads."[57] According to commentators who have reviewed all of the approximately two hundred of these "leases," the "essential idea" was a complete conveyance of one operating railroad to another — rolling stock, contracts and all.[58] For this reason, "a standard covenant" of the railroad "lease" was the lessee's "promise to discharge the duties imposed by law upon the lessor, such as its duty as a common carrier."[59]

Relatively late in their history, operating railroads also began to enter into "leases" and trackage agreements which had short terms or were terminable at will. Since lease rentals were "an important part of the fixed charges of many railroads,"[60] the flexibility of these arrangements made them economically attractive to the "lessees" as well as the "lessors."

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[55] Hence the reference in *Thompson* v. *Texas Mexican Ry.*, 328 U.S. 134, 145 (1946).

[56] *See* 49 U.S.C. § § 1(1), 1(18) and CHERINGTON, THE REGULATION OF RAILROAD ABANDONMENTS 43-58 (1948).

[57] Meck, *The Problems of The Leased Line*, 7 LAW & CONTEMP. PROBS. 509, 510 (1940).

[58] Meck & Masten, *Railroad Leases and Reorganizations: I*, 49 YALE L.J. 626, 632 (1940).

[59] *Id. at* 635 n.37.

[60] Meck, *supra*, at 509.

Under these circumstances, it might not have been unreasonable to interpret Section 1(18) to permit the ICC to require a railroad "lessor" to resume a common carrier service it had undertaken but then "leased" to another railroad, but the question was regarded as a close and doubtful one.[61] As the railroad industry went into a marked decline with the onset of the great depression, and railroad bankruptcies and reorganizations became more common, Congress addressed the problem directly. Paragraph (c)(6) of Section 77 of the Bankruptcy Act, 11 U.S.C. § 205, added by the Railroad Reorganization Act Amendments of 1933, provided that if a lessee goes into Section 77 proceedings and elects not to operate the leased line, "it shall be the duty of the lessor ... to begin operation of such line" unless the bankruptcy judge finds this would be impracticable. In that event the lessee must continue operations "on or for the account of the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of [the Interstate Commerce Act]."

Interstate pipelines are roughly analogous to interstate railroads, but oil and gas leases and interstate gas sales by producers are vastly different from railroad leases and service. No producer who sells natural gas is a "natural-gas company" subject to Commission jurisdiction under the Natural Gas Act with respect to a particular sale unless that particular sale is a sale for resale in interstate commerce. Under an oil and gas lease the lessor creates and conveys a genuine real property interest; he is not a seller of natural gas when he executes the lease; he is not a "natural-gas company" by reason of the lease; he therefore transfers no "natural-gas company" obligations to the lessee, comparable to the "common carrier" duties conveyed by the typical railroad lessor. For the same reason, his mineral fee interest is subject to no obligation to "resume" service. Congress has never passed an express statutory provision, comparable to Section 77(c)(6) of the Bankruptcy Act, under which an oil and gas lessor can be

[61] *See* Friendly, *Amendment of the Railroad Reorganization Act*, 36 COLUM. L. REV. 27, 48-49 (1936).

obligated to perform any interstate service obligations his lessee may elect to undertake.

Further, while railroad "leases" and trackage agreements which have short terms or are terminable at will are common because they make economic sense, oil and gas leases with short fixed terms or terminable at will are unknown[62] because they make no economic sense. The oil and gas lessee's major investment is in drilling costs, and he counts on recovering that investment by marketing all of the reserves, if any, that he discovers.[63] Thus, in the oil and gas industry, there is no danger that lessees, under short-term leases or leases terminable at will, would attempt to commence interstate sales that the lessors could terminate shortly thereafter.[64]

In view of these fundamental differences, there is little reason to look to railroad abandonment cases involving "leases" for illumination as to the appropriate principles to apply with respect to a producer sale under the Natural Gas Act by a lessee under a fixed-term lease. Such light as the railroad cases do shed supports the decision of the court of appeals.

B. Under The Interstate Commerce Act, Only A Lessor Who Is Performing A Railroad Service When The Lease Was Made Is Subject To ICC Abandonment Jurisdiction When The Lease Expires.

In attempting to draw their ICC abandonment analogy, the Commission et al. rely upon two decisions of this

[62] As previously pointed out, *supra* note 1, all modern oil and gas leases last as long as the lessee maintains production in paying quantities. Even leases with long fixed terms, such as Gulf's Waddell Ranch lease, are extremely rare and outdated.

[63] This is precisely why lessees stopped agreeing even to *long* fixed-term leases by 1928, and insisted on the ordinary lease, which is capable of lasting indefinitely. *See* 3 H. WILLIAMS, OIL & GAS LAW § 601.1 at 2-3 (1975).

[64] As discussed in Part IV, pages 37-45, *infra*, the decision below does not impair the Commission's ample existing authority to protect the interstate market against the commencement of unreliable service by a lessee under a hypothetical lease terminable at will.

Court and two ICC decisions.[65] Each of the cases involved an agreement which was entered into between two operating railroads.[66] Thus, none stand for the proposition that under Section 1(18) the ICC may require a lessor which was not a railroad when the lease was made to undertake railroad service being performed by the lessee upon the termination of the lease.

The two decisions of this Court do not even hold that a lessor which *was* a carrier by railroad with respect to the roadbed in question when the lease was made can be forced under Section 1(18) to resume operations upon termination of the lease. Both *Smith* and *Tex-Mex* involved attempts by one railroad to oust another railroad from its tracks when the latter went into bankruptcy and reorganization proceedings under Section 77. This Court held that, while the bankruptcy court had the power to declare lease forfeiture in *Smith* and contract termination in *Tex-Mex*, since the "nature of the plan of reorganization . . . is entrusted primarily to the Commission," primary jurisdiction lay with the ICC and the courts were premature in declaring forfeiture. 328 U.S. 132-33; *see also* 328 U.S. at 141-42.[67]

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[65] *Smith* v. *Hoboken R.R., W&S.S.C.Co.*, 328 U.S. 123 (1946); *Thompson* v. *Texas Mexican Ry.*, 328 U.S. 134 (1946); *Chicago & Alton R.R.* v. *Toledo, P.&W. Ry.*, 146 ICC 171 (1928); and *Lehigh Valley Railroad Co. Proposed Abandonment of Operation*, 202 ICC 659 (1935).

[66] Only the *Lehigh Valley* case involved a fixed-term lease. *Smith* involved a lease terminable at will. *Tex-Mex* and *Chicago & Alton* involved trackage contracts, which create "only a personal obligation" and not an estate in property. 328 U.S. at 140. In each case the owner of the tracks was an operating railroad when it entered into the agreement, although in *Lehigh Valley* the lessor had ceased to operate railroad properties after entering into the lease.

[67] In *Smith* this Court did note that the ICC had denied the lessor's application for authorization to "resume operations of the railroad" on the grounds that the lessor's original obligations as a carrier by railroad "have never ceased" and, therefore, must be "performed by the lessor on its own behalf." 328 U.S. at 129. This is the closest that this Court has ever come to holding that under Section 1(18) a lessor which *was* a carrier by railroad when the lease was made can be forced to resume its own prior railroad operations when the lease terminates.

The *Chicago & Alton* ICC decision also involved an attempt by one railroad which was party to a trackage agreement to cancel the agreement when the other railroad went into receivership. The ICC decided that it had power under Section 3(4) of the Interstate Commerce Act to require the former to extend its service to replace that previously performed by the latter; no comparable provision exists under the Natural Gas Act.[68]

Only the *Lehigh Valley* ICC decision involved a "lease" which terminated by operation of law. Even in *Lehigh Valley* the "lease" was a device by which the lessor had transferred his own common carrier duties to the lessee. The ICC noted that the lessor had voluntarily dedicated its property to common carrier railroad service in the first place. Relying on this Court's decisions concerning such dedications under common law, the ICC accordingly held that:

> [t]he subsequent lease of its railroad to another company did not change the lessor's relations to the public, nor relieve it from performance of the duties and obligations imposed by its charters or the general laws of the State . . . .

202 ICC at 663.

What the Second Circuit held in *Meyers* v. *Famous Realty, Inc.*, 271 F.2d 811 (2d Cir. 1959), *cert. denied*, 362 U.S. 910 (1960), is equally true here:

> None of the decisions cited held or implied that a noncarrier, by merely leasing its properties to a carrier, becomes a 'carrier by railroad' or incurs any obligation to perform its railroad operations when its lease expires.

271 F.2d at 814.

On the contrary, *Meyers* held, and it is the "settled construction" of Section 1(18), that a lessor may be required

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[68] The ICC did also hold that under Section 1(18) it had power over railroad operations under trackage agreements between two carriers by railroad. 146 ICC at 180-81. This is the *only* proposition for which this Court in *Tex-Mex* cited *Chicago & Alton* with approval. *See* 328 U.S. at 144.

to obtain abandonment authorization "only when the lessor was a 'carrier by railroad'... when the lease was made." *City of New York* v. *United States,* 337 F.Supp. 150, 153 (E.D.N.Y. 1972) (three-judge panel) (Friendly, J.).

The Second Circuit's interpretation of Section 1(18) is also the ICC's interpretation. In *Bush Terminal R.R. Entire Line Abandonment,* 342 ICC 34, 50 (1971), the ICC summarized the holding of *Lehigh Valley* and similar cases as follows:

> When a carrier leases its rail facilities to another, it is under a revived obligation to operate its railroad property on its own behalf upon discontinuance of operations by the lessee, unless the lessor receives an abandonment order from the Commission.

On the other hand, "a non-carrier, by merely leasing its properties, does not become a carrier by railroad . . . ." *Id.*

The Commission attempts to distinguish these cases on the grounds that in *Meyers* and *City of New York* the lessee had already been granted abandonment. This distinction is spurious. The Second Circuit expressly declined to rely on the prior grant of abandonment to the lessee. It stated that:

> We hold that a carrier which leases mere trackage rights to another carrier is under no obligation to carry on that other carrier's operations when its lease expires *or* that other carrier's operations are legally abandoned.

271 F.2d at 814 (emphasis supplied). That is, under Section 1(18) *neither* the expiration of a lease *nor* a grant of abandonment to a lessee carrier by railroad obligates a non-carrier lessor to perform railway service.

Giving up the attempt to distinguish *Meyers,* the Commission accuses Southland Royalty of using it to contend that a successor-in-interest is "not within the Commission's jurisdiction and thus does not need permission to cease interstate sales," a proposition which "would eviscerate the Natural Gas Act" and "would be equally

devastating" if applied to the Interstate Commerce Act. (FPC at 28). Southland Royalty makes no such contention. As demonstrated above, pages 22-26 *supra,* a successor-in-interest unquestionably does need the Commission's permission to cease interstates sales.[69] But Southland Royalty is not a "successor-in-interest" to Gulf. Gulf's lease expired according to its terms. Southland Royalty thereupon came into present enjoyment of the mineral fee estate it had always owned, an estate which Gulf had never owned and could not have dedicated to interstate service. *Meyers* has been the law for eighteen years without "devastating" the Interstate Commerce Act and the Commission offers no factual or legal basis for its claim that an analogous holding in this case would "eviscerate" the Natural Gas Act.

IV. THE DECISION OF THE COURT OF APPEALS DOES NOT IMPAIR THE COMMISSION'S REGULATORY AUTHORITY.

The Commission et al. urge reversal of the court of appeals' decision in order to prevent three types of potential injury to the Commission's jurisdiction allegedly resulting from the decision below. First, they assert that large quantities of gas dedicated to interstate service in this and other fixed-term lease expiration cases will be "released" or "withdrawn" from such service without the Commission's approval. Second, they contend that the decision below will be dispositive of other cases involving premature termination of conventional oil and gas leases and thereby will inevitably result in "withdrawal" of dedicated reserves. Third, they claim that lessors and lessees will be able to draft future leases in novel ways that will "maximize both parties' options to leave the interstate market when this served their mutual advantage." (FPC at 30 n.29). These contentions are without merit.

[69] Thus, if a lessee sells his leasehold interest, or dies and his leasehold interest passes to his heirs, his successors have the same obligations to produce his leasehold gas and sell it in interstate commerce as the lessee himself did. But Gulf did not sell or otherwise transfer its leasehold interest to Southland Royalty, and only Gulf's leasehold interest was dedicated to El Paso.

A. The Court Of Appeals' Decision Does Not "Release" From Interstate Service Any Dedicated Gas.

To assert that the court of appeals' decision will permit large quantities of gas "dedicated" to the interstate market by fixed-term lessees to be "released" or "withdrawn" from the interstate market begs the question. Gulf has already delivered all its fixed-term leasehold gas to El Paso, so none of Gulf's gas could be "withdrawn" from interstate service by anyone. If, as the court below held, Gulf had no power to dedicate Southland Royalty's gas, Southland Royalty's gas is not dedicated to interstate service. If Southland Royalty's gas is not dedicated, it will not be "released" or "withdrawn" from such service when Southland Royalty sells it to Intratex.[70]

B. The Court of Appeals' Decision Does Not Determine The Outcome Of Cases Involving Premature Termination Of Oil And Gas Leases.

The Commission et al. recognize that "fixed-term leases" of the kind involved here are no longer common (FPC at 30), and do not deny that such oil and gas leases had "long been in disuse" by 1928.[71] They contend, however, that "the rationale of the court below" (FPC at 30) would apply in ordinary lease cases "when a lease terminates for any reason." (El Paso at 23). They base this concern primarily on *Pennzoil Producing Co.* v. *FPC*, 553 F.2d 485 (5th Cir. 1977).[72] Analysis of *Pennzoil* demonstrates that this argument is a make-weight.

In *Pennzoil*, two producers-lessees were making interstate sales, at Commission-regulated rates, of gas produced under their ordinary leases. They were faced with lessors' Louisiana state court suits for higher "market value" royalty payments. Under Louisiana law, lease forfeiture is a

[70] As previously noted, *supra* note 22, the Commission et al. grossly exaggerate the amount of gas involved.

[71] *See* note 1, *supra*.

[72] They also point to *Northern Natural Gas Co.* v. *Crawford*, FPC Docket No. C571-6, issued September 29, 1975, *appeal docketed sub nom. Harrison* v. *FPC*, No. 76-4318 (5th Cir. Dec. 19, 1976).

possible though extremely rare remedy for improper royalty payments.[73] The producers petitioned the Commission for relief. They sought two forms of relief, in the alternative: First, an increase in the price they could charge to cover the amount of increased royalty they might have to pay if they lost or settled; or, second, authorization to "abandon" the interstate sale of a fraction of the gas produced so that it could be delivered to the royalty owner in kind. The Commission denied relief. It held that it had no authority to permit the producers to sell their gas at rates above the otherwise applicable ceiling rates, notwithstanding the increased costs of "market value" royalty obligations, and that the "present or future public convenience or necessity" did not require abandonment of the royalty portion of the lessees' dedicated gas.

The Fifth Circuit reversed and remanded. With respect to the rate relief sought by the producers, the Fifth Circuit noted that under the cost-based rate regulation methodology approved by this Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Commission did have the authority to protect the producers' Commission-set just and reasonable rates by allowing higher prices to cover increased costs, including royalty costs. With respect

[73] The Commission says that the leases in *Pennzoil* "contained standard provisions for termination in the event royalties were not paid as required" (FPC at 31). We believe that the leases in *Pennzoil* contained no such provisions, but in any event such provisions are certainly not "standard." On the contrary, "[o]il and gas leases ordinarily do not contain an express provision empowering the lessor or royalty owner to declare a forfeiture thereof for the non-payment of gas well rentals or oil and gas royalties from production." 3A W. SUMMERS, THE LAW OF OIL & GAS § 616, at 516 (1958). Only two Louisiana cases have declared forfeitures for improper royalty payments absent such an express lease provision. Both were decided before the recent liberalization of that state's mineral code, no other state courts have ever declared such a forfeiture absent an express clause, and the commentators are without exception opposed to such forfeitures. *See id; see also* 3 H. WILLIAMS, OIL & GAS LAW § 656.2 (1975). New York's contention that leases commonly provide for forfeiture in the event that the lessee makes a regulated sale (N.Y. at 4) is equally unsupported and equally erroneous. New York is probably confusing leases with intrastate gas sales contracts, where sellers do commonly insist on provisions prohibiting interstate resales of their gas by the purchasers.

to the requested abandonment, the court stated that, under its decision in the present case, if the producers in *Pennzoil* lost the state court litigation they might face termination of their leases and resulting diversion of the entire amount of gas from interstate commerce, which might be worse for the public interest than the relief requested.

The Commission then petitioned for rehearing. The Commission argued that "having decided to remand the rate relief issue . . . for consideration on the merits, it was unnecessary and premature for the court to then consider" the "tangential" lease termination issue which "might not thereafter arise." The Commission reminded the court of appeals that it should not "indulge in any dicta on 'what if,' or hypothetical, propositions which may never occur. We are not allowed the luxury of advisory opinions."[74] The Commission then urged the court to "withdraw the specified portions" of its opinion. In response, the court agreed to "pull from the opinion any indication as to how *Southland* might apply to the facts of this case." (*See* FPC at 5a).[75]

In its petition for rehearing in *Pennzoil*,[76] the Commission also argued at length that the court of appeals' apparent decision in that case of the ordinary lease termination issue was in error. The Commission contended that the termination of the leases involved would not result in diversion of the gas from interstate commerce even if the court of appeals' decision in this case were affirmed. The Commission noted that the leases in *Pennzoil* were ordinary

[74] The Commission was quoting from the Fifth Circuit's decision in *Mitchell Energy Corp.* v. *FPC*, 533 F.2d 258, 261-62 (5th Cir. 1976).

[75] The Commission now chastises the court of appeals for withdrawing only the last two sentences of its opinion in *Pennzoil*. These two sentences were, however, the *only* portions of the court's opinion which the Commission actually quoted as the subject of its petition for rehearing. In any event, the court of appeals' intent was, clearly and expressly, "to pull from the opinion any indication as to how *Southland* might apply to the facts of this case."

[76] Southland Royalty is contemporaneously lodging with the Court copies of this petition for rehearing.

leases, capable of lasting indefinitely. Thus, unlike Gulf, the lessees owned all the gas reserves in question and could and did commit all such reserves to their interstate sale. Therefore, the Commission claimed, even if the lessors secured premature termination through their state court suit, the entire gas supply had been "once dedicated" by the lessees and could not be withdrawn. That is, the Commission has clearly and explicitly told the court of appeals that this case is distinguishable from *Pennzoil*.

Likewise, the Commission told the court of appeals that it was premature to decide in *Pennzoil* what the effect of an early termination of an ordinary lease would be. The court of appeals agreed. The Commission cannot now claim that the court of appeals has decided that issue in *Pennzoil*, and decided it wrongly, and must be reversed in *this* case.[77] This Court simply has "no occasion to decide" the ordinary lease termination question. "Decision of that question must await a case which presents it." *Gainesville Utilities* v. *Florida Power Corp.*, 402 U.S. 515, 529 (1971).[78]

C. The Commission Has Authority To Prevent Lessees From Commencing Interstate Sales And Subsequently Withdrawing Their Dedicated Gas From Interstate Service.

The Commission et al. contend that, even if the court of appeals' decision is correct on the facts of this case, this court must reverse in order to prevent future lessors and lessees from entering into novel types of leases which would permit them to "freely move from the interstate market to the intrastate market with the Commission helpless to consider the public interest." (Calif. at 30). Unless the court of appeals' decision is reversed or

[77] The Commission may seek certiorari from the court of appeals' decision in *Pennzoil*. To our knowledge, it has not yet done so.

[78] The issues in the *Harrison* appeal, note 72 *supra*, are, of course, even more "tangential" and "premature" here. The only decision that we have so far is the decision of the Commission, and the Commission has vigorously defended its decision in the court of appeals.

limited,[79] they contend, such novel leases will become "prevalent" and "the purposes of the Natural Gas Act will be undermined." (FPC at 33).

The nature of this argument should be carefully considered. The Commission et al. request judicial creation of Commission jurisdiction, not conferred by Congress, compelling an involuntary interstate sale by Southland Royalty. They base their request on speculation, completely without record support, about what some other producers might do in the future on some other facts. Such an argument must be rejected for four reasons.

First, no danger is presented on the facts of this case.[80] Gulf's lease was entered into long before the passage of the Natural Gas Act, and almost thirty years before the Act was ever held to apply to producer sales. Gulf itself commenced its sale of its leasehold gas before the Act was held to apply to such a sale. Gulf committed to its sale all of the Waddell Ranch lease casinghead gas that Gulf owned, with no attempt to reserve an option to sell any portion of its casinghead gas in the intrastate market. Southland Royalty, on the other hand, has never sold any gas from the Waddell Ranch in interstate commerce (except involuntarily under compulsion of the Commission's orders

[79] In its *amicus* brief, New York recognizes that the decision of the court of appeals was rendered in the context of the expiration of a fixed-term lease but states that it is "afraid" the rationale of such decision "could not be so limited." *See* N.Y. at 3. Southland Royalty suggests that the court of appeals' decision does not constitute any authority for a case in which a lessee voluntarily terminates his lease, before its natural expiration, knowing that commercially producible reserves exist and intending to permit them to be sold by the lessor in intrastate commerce. Nor does the court of appeals' decision intrinsically authorize a lessor to prematurely terminate a lease when commercially producible reserves are known to exist, in an effort to take away the lessee's right to sell his leasehold gas in interstate commerce. If the rationale of the court of appeals' decision does appear to extend so far, this Court clearly can and should limit it. No such limitation, however, requires reversal.

[80] The most that the Commission contends is that the danger "of manipulation of Commission jurisdiction by restructuring leases" is "suggested by this case." (FPC at 24). The Commission offers no support for this statement.

in the present case), and thus certainly has made no attempt to commence an interstate sale and then later "reassess" whether it desired to serve the interstate market.

Second, it is for Congress to decide when Commission jurisdiction is necessary to achieve a purpose or eliminate an evil. It was argued in *Chemehuevi Tribe of Indians* v. *FPC,* 420 U.S. 395 (1975), that unless particular conduct was held by the courts to be subject "to the licensing jurisdiction of the Commission," private parties would succeed in achieving "the very evil" that the Act "was designed to eliminate." This Court unanimously rejected the argument. "Whatever the merits of complainants' argument as a matter of policy, it is properly addressed to Congress, not to the courts." 420 U.S. at 423.[81]

Third, the danger hypothesized is simply implausible. The lessee is the party who explores for natural gas. The great bulk of his investment risk is in drilling costs. He has no incentive to enter into short fixed-term leases or leases terminable at will because such leases would take away his incentive to make the investment: his opportunity to market all of the gas he finds, and thus over the long run, averaging discoveries and dry holes, to return a profit. This was precisely the reason why, in the 1920's, producers stopped entering into even long fixed-term leases, such as Gulf's lease in the present case, and instead went to ordi-

[81] Each House of Congress has already passed legislation which would foreclose any serious possibility of future leases of the type feared by the Commission et al. *See* H.R. 8444, 95th Cong. 1st Sess. (1977), passed by the House of Representatives on August 5, 1977, 123 Cong. Rec. H8827 (daily ed. Aug. 5, 1977) and S. 2104, 95th Cong., 1st Sess. (1977), passed by the Senate on October 4, 1977, 123 Cong. Rec. S16323 (daily ed. Oct. 4, 1977). As to future sales of gas, either of these bills, if it became law, would eliminate the disparity between interstate and intrastate prices which allegedly creates the incentive for lessees to enter into short-term leases, commence interstate service, and then "reassess" serving the interstate market. In this connection, the Commission states that H.R. 8444 "would not affect the large bulk of gas that is currently being produced," FPC at 7 n.9, but this is simply incorrect. H.R. 8444 would impose price ceilings on all categories of producer gas sales – both interstate sales and intrastate sales, and both "old" gas and "new" gas.

nary leases which last as long as the lessee maintains any production in paying quantities.[82]

Fourth and finally, the Commission is by no means "helpless" to prevent a lessee from commencing interstate service while reserving for himself or his lessor the ability to withdraw his leasehold gas from such service at the option of either. The Commission can simply refuse to authorize the proposed sale. Alternatively, the Commission can condition the certificate it issues on the lessee-applicant obtaining a longer term leasehold interest for commitment to the sale.

The Commission's power to protect the interstate market in such situations is illustrated by its recent decision in *Transco Exploration Co.*, Docket No. CI77-306, issued June 27, 1977.[83] There the Commission refused Transco Exploration's request for a certificate with pregranted abandonment to make an interstate sale of twenty-five percent of its leasehold interest in a gas field. Transco Exploration requested pregranted abandonment effective on the date that the producer which had assigned the lease to Transco Exploration exercised its right to require Transco Exploration to reassign to the producer a twenty-five percent share of the lease. The Commission held that to grant the request for pregranted abandonment would undermine its orders which were sustained by the Tenth Circuit in *Phillips, supra,* and would "encourage other potential working interest owners to include a similar prohibition in future assignments." *Id.* at 3.[84]

[82] *See* 3 H. WILLIAMS, OIL & GAS LAW § 601.1 at 2-3 (1975).

[83] The case is merely illustrative, because it involved a farmout or contract between the assignor of a lease and his assignee, rather than a lease provision.

[84] On September 19, 1977, the Commission granted rehearing of this order and issued Transco Exploration the limited-term certificate with pregranted abandonment which it originally sought. The Commission stated again that it intended to continue its "general policy" of not issuing such certificates where they would encourage assignors to make "long-term dedication of gas in interstate market impermissible" under the terms of their lease assignments. *Id.* at 2. The Commission made an exception for Transco Exploration because of special circumstances but stated that "in order to discourage this type of arrangement" it would "refuse to apply" any such exception even to "pipeline affiliates with regard to farmout or similar arrangements executed on or after the date of issuance of this order." *Id.* at 3-4.

The Commission should certainly protect the interstate market against any producer who tries to make an unreliable sale of natural gas. As *Transco Exploration* illustrates, the Commission has ample power under Section 7(e)[85] to protect the interstate market against any such unreliable seller. However, protection of the interstate market against such hypothetical sales does not require a holding in this case that by making an interstate sale of all of the gas attributable to its long fixed-term lease, Gulf also dedicated gas in which it never had any ownership or other interest — the gas owned by Southland Royalty and produced by it after the expiration of Gulf's lease.

[85] Under Section 7(e) the Commission has the power to reject or condition the certificate of public convenience and necessity which a producer must obtain before initiating an interstate sale of its natural gas.

CONCLUSION

Gulf's interstate sale of Gulf's leasehold gas did not dedicate Southland Royalty's gas to interstate service. Certainly, Gulf had no power under property law to encumber Southland Royalty's gas with an interstate service dedication. Likewise, Gulf had no power under the Natural Gas Act to dedicate Southland Royalty's gas to Gulf's interstate service. Since Southland Royalty's gas has not been dedicated to interstate service, Southland Royalty may sell its gas to the purchaser of its choice without obtaining Commission authorization to abandon interstate service. For these reasons, the decision of the court of appeals should be affirmed.

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